ORIGINAL

DOCKET FILE COPY ORIGINAL

Wiley, Rein & Fielding

1776 K Street, N.W.
Washington, D.C. 20006
(202) 719-7000
Fax: (202) 719-7049
www.wrf.com

WRITER'S DIRECT DIAL
(202) 719-3224

WRITER'S INTERNET ADDRESS
DJSMITH@WRF.COM

October 27, 1999

RECEIVED

OCT 27 1999

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Magalie Roman Salas, Secretary
Federal Communications Commission
12th Street Lobby, TW-A325
445 Twelfth Street, S.W.
Washington, DC 20554

Re: ERRATUM: Petition for Reconsideration in CC Docket Nos. 96-262, 94-1, 98-157 and CCB/CPD File No. 98-63

Dear Madam Secretary:

Attached is a corrected version of the Petition for Reconsideration filed by GTE Service Corporation in the above listed proceedings filed on October 22,1999. This version corrects the last sentence in the last paragraph in the Introduction section (page 4) that was inadvertently cut-off and adds a citation. As corrected, the sentence now reads: "Therefore, GTE respectfully asks the Commission to revise Section 69.123(d) to be consistent with the policy announced in the *Fifth Report & Order* to remove all competitive prerequisites for deaveraging.". A citation has been added to the sentence following footnote 35.

If you have any additional questions, please do not hesitate to contact the undersigned.

Sincerely,

Daniel J. Smith

No. of Copies rec'd 0+17
List ABCDE

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Access Charge Reform	)	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63
Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	CC Docket No. 98-157

PETITION FOR RECONSIDERATION

GTE SERVICE CORPORATION, and
identified affiliates

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036

Thomas R. Parker
GTE Service Corporation
600 Hidden Ridge, MS HQ-E03J43
P.O. Box 152092
Irving, Texas 75015-2092

Gregory J. Vogt
Daniel J. Smith
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006-2304

Its Attorneys

October 22, 1999

(Corrected)

TABLE OF CONTENTS

Page

I. INTRODUCTION & SUMMARY 2

II. THE FCC MUST NOT ELIMINATE THE LOW-END ADJUSTMENT MECHANISM IF A PRICE-CAP LEC ELECTS TO EXERCISE PHASE I OR II PRICING FLEXIBILITY 4

A. Eliminating the Low-End Adjustment Is Unlawful Because It Could Prevent the Company from Earning a Reasonable Return on Investments 4

B. Eliminating the Low-End Adjustment on a Company-Wide Basis Is Not Necessary To Prevent Anti-Competitive Behavior 8

III. THE COMMISSION MUST REVISE SECTION 69.123 TO CONFORM TO THE ORDER'S ELIMINATION OF THE COMPETITIVE PREREQUISITES TO DEAVERAGING 12

VI. CONCLUSION 13

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Access Charge Reform	)	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63
Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	CC Docket No. 98-157

PETITION FOR RECONSIDERATION

GTE Service Corporation and its below-listed affiliates[1] (collectively "GTE"), pursuant to Section 1.429 of the Commission's Rules[2] hereby submit this Petition for

[1] GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

[2] 47 C.F.R. § 1.429. As a party that participated in these proceedings, GTE most certainly is an "interested person" and, as such, has standing to file this Petition. 47 C.F.R. § 1.429(a).

Reconsideration ("Petition") to request that the Commission reconsider certain aspects of its *Fifth Report & Order* in the above-captioned proceedings.[3]

I. INTRODUCTION & SUMMARY

In the *Fifth Report and Order*, the FCC adopts a rule that prohibits any price-cap local exchange carrier ("LEC") or its affiliate that obtains "Phase I or Phase II pricing flexibility for *any* service area in *any* MSA ... from making *any* low-end adjustment ... in *all* or part of its service region."[4] The Commission emphasizes that the prohibition will apply "throughout [the carrier's] entire, holding-company-wide service region."[5] The rationale for adopting this policy is that a set of burdensome cost allocation rules would be required if it continued to permit the low-end adjustment to be used.[6] Further, the Commission believes that the elimination of the adjustment mechanism will not result in confisicatory rates because carriers will continue to have the option to make above-cap tariff filings.[7]

---

[3] Access Charge Reform, CC Docket No. 96-262; Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, CCB/CPD File No. 98-63; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket No. 98-157, *Fifth Report and Order, and Further Notice of Proposed Rulemaking*, FCC 99-206 (rel. Aug. 27, 1999) ("*Fifth Report and Order*").

[4] 47 C.F.R. § 69.731 (1999) (emphasis added). This rule was published in the FEDERAL REGISTER on September 22, 1999. *See Access charge reform; local exchange carriers price cap performance review*, 64 Fed. Reg. 51258 (Sept. 22, 1999). In accordance with 47 C.F.R. § 1.4(b) and 47 C.F.R. § 1.429(d), this Petition is timely filed.

[5] *Fifth Report and Order*, at ¶ 167.

[6] *Id.*

[7] *Id.*

This rule is wrong. By forcing price-cap LECs to surrender this right, Section 69.731 not only fails to advance the public policy goals enunciated in the *Fifth Report and Order*, but it also is patently unlawful. Section 69.731 is unlawful because the elimination of the low-end adjustment mechanism as an option for price-cap LECs fails to preserve the Fifth Amendment requirements imposed upon any rate regulation scheme to not be confisicatory. Even putting constitutional considerations aside, the elimination of the low-end adjustment mechanism is unreasonable because its continued availability will not result in price-cap LECs using the mechanism to support anti-competitive behavior. Therefore, in this Petition, GTE respectfully requests that the Commission eliminate Section 69.731 and its requirement prohibiting a price-cap LEC from exercising its right to claim a low-end adjustment, if it takes advantage of any of the pricing flexibility outlined for Phases I and II.[8]

In addition, GTE asks that the Commission revise Section 69.123(d) in a manner consistent with the express statements in the *Fifth Report and Order*. In that order, the Commission states that it has amended its rules to eliminate prerequisites for the

---

[8] GTE encourages the Commission to adopt the program outlined by the Coalition for Affordable Local and Long Distance Service Plan ("CALLS"), which will achieve a result similar to the policy advocated by the Commission in the *Fifth Report and Order* but in a reasonable and lawful manner. Under this proposal several price-cap LECs have voluntarily agreed not to use the low-end adjustment for the duration of the interim plan. It is important to note that this agreement is the result of a series of compromises and tradeoffs made by each member of CALLS during the negotiations and discussions that led to the CALLS proposal that balances company-wide obligations and benefits. In light of the integrated and voluntary nature of the CALLS proposal, the LECs' agreement to waive their right to the low-end adjustment is reasonable in those circumstances. However, if the Commission were to strip this requirement out from the overall framework of the CALLS proposal, the mandatory nature of the requirement and the loss of context renders the requirement unlawful and unreasonable.

deaveraging of trunking basket service rates.[9] Yet, in the text of the rules that were actually adopted, the Commission neglected to revise Section 69.123(d), which requires that charges for sub-elements of certain trunking services cannot be deaveraged unless at least one interconnector has taken a cross-connect in a study area.[10] This oversight must be corrected. Therefore, GTE respectfully asks the Commission to revise Section 69.123(d) to be consistent with the policy announced in the *Fifth Report & Order* to remove all competitive prerequisites for deaveraging.

II. THE FCC MUST NOT ELIMINATE THE LOW-END ADJUSTMENT MECHANISM IF A PRICE-CAP LEC ELECTS TO EXERCISE PHASE I OR II PRICING FLEXIBILITY

A. Eliminating the Low-End Adjustment Is Unlawful Because It Could Prevent the Company from Earning a Reasonable Return on Investments

By taking the broad approach of eliminating the low-end adjustment for a price-cap LEC once it has taken advantage of the price flexibility rules, the Commission has adopted a rule that could prevent a price cap company from having the opportunity to earn a reasonable rate of return on its investments. Such a rule violates the price-cap LEC's Constitutional rights by violating the Fifth Amendment.

When devising rules to regulate a carrier's rates, the Commission must ensure that a company is guaranteed under the rules the opportunity to earn a rate of return that fairly compensates the company. As the Commission is well aware, this is constitutionally required by the Fifth Amendment.[11] In *Hope Natural Gas*, the Supreme

---

9 *See Fifth Report and Order*, at ¶ 62.

10 47 C.F.R. § 69.123(d).

11 *See, e.g., Southwestern Bell Telephone Company; Tariff F.C.C. No. 73*, 13 FCC

(Continued...)

Court clearly enunciated this principle by holding that any rate regulation scheme must guarantee that the regulated rates will "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed."[12] Thus, the rates must ensure that the return on the investments "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[13]

Thus, in conformance with this constitutional requirement, the Commission adopted the low-end adjustment because a failure to do so "could harm customers as well as stockholders" of a price-cap LEC.[14] The Commission reasoned that if a price-cap LEC were required to take unusually low earnings as a result of the rules governing its prices, this fact "could threaten the LEC's ability to raise the capital necessary to provide modern, efficient services to customers."[15] Despite other changes and modifications to the rules by which the price cap rates were calculated, the Commission has relied over the years upon the low-end adjustment as a necessary constitutional

---

(...Continued)
Rcd 6964, ¶ 17 (1998) (noting that price cap rates must not affect a company's "financial integrity and prevent it from raising capital, or fail to compensate [it] with returns on investment commensurate with other enterprises having corresponding risks" to satisfy the Fifth Amendment).

12 *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 605 (1944); *see also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 15499, ¶ 734-37 (1996) (using the *Hope Natural Gas* analysis for rate regulation).

13 *Hope Natural Gas*, 320 U.S. at 603.

14 *Policy and Rules Concerning Rates for Dominant Carriers* (Second Report and Order), 5 FCC Rcd 6786, 6804 (1990) ("*LEC Price Cap Order*").

15 *LEC Price Cap Order*, at 6804.

safeguard. For example, the protection rationale was reiterated when the Commission revised the price cap structure and adopted a new X-Factor.[16] In that proceeding, the Commission reaffirmed the use of a low-end adjustment mechanism as a system that "provides adequate protection for those [price-cap] LECs."[17]

Obtaining price flexibility does not mean that a carrier no longer needs protection. Under the Commission's new rules, a carrier can only obtain flexibility on an area-by-area basis—the remainder of the company's service area remains under the price cap rules. Yet, under the new rules, the ability of the price cap carrier to use the low-end adjustment mechanism is eliminated when a carrier enjoys pricing flexibility in just a single MSA. Extending the prohibition to any affiliate of the same entity enjoying relief aggravates the constitutional injury. This rule completely ignores the fact that price flexibility in one area does not negate the need for the protective benefits of the low-end adjustment mechanism, particularly when rates are still regulated in other areas. The fact that a carrier enjoys price flexibility in one area does not eliminate the Commission's obligation to ensure that the price-cap LEC has the ability to earn the constitutionally required rates of return the Court in *Hope Natural Gas* discussed.

The Commission's conclusion that the elimination of "the low-end adjustment will not result in confisicatory rates, because [it] will continue to permit price cap LECs to make above-cap tariff filings" fails to satisfy the requirements of the Fifth Amendment. The Supreme Court has stated that the Fifth Amendment requires that the rate

---

16 *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, 12 FCC Rcd 16642 (1997) ("*Access Reform Second Report & Order*").

17 *Access Reform Second Report & Order*, at 16704-05.

regulated entity have a "'reasonable, certain and adequate provision for obtaining compensation.'"[18] Yet, the Commission's own statements regarding the above-cap tariff filing calls into question the reasonableness of this alternative. For instance, the Commission has stated that it will make it difficult for an above-cap filing to win its approval by subjecting such filings to "a different and higher review standard" than other tariff filings.[19] In addition, any carrier seeking redress will face an automatic delay of at least five months while the Commission investigates the filing.[20] Finally, the FCC has stated that it will be "unlikely" that such "filings will be found lawful."[21]

One reason the Commission could disfavor and discourage above-cap filings by telling carriers they are presumed unlawful was the low-end adjustment. As the Commission stated in the *LEC Price Cap Order*, these additional barriers would not result in a taking by preventing a carrier from "the opportunity to attract capital and continue to operate" because, in part, of the availability of the low-end adjustment mechanism.[22] Under Section 69.731, this expectation can no longer be squared with the Commission's previous statements. Because the Commission has eliminated the low end adjustment mechanism without a corresponding adjustment in the above-cap

---

18 *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 124-25 (1974) (quoting *Cherokee Nation v. Southern Kansas R. Co.*, 135 U.S. 641, 659 (1890)).

19 *LEC Price Cap Order*, at 6823.

20 *Fifth Report and Order*, at ¶ 168 n.419 (noting that the Commission "would probably suspend any above-cap filing for the statutory five-month period"). Reasonableness depends, in part, upon "the length of the delay and the impact on a citizen of the challenged order." *Tenoco Oil Co. v. Department of Consumer Affairs*, 876 F.2d 1013, 1027 (1st Cir., 1989).

21 *LEC Price Cap Order*, at 6823.

22 *LEC Price Cap Order*, at 6823.

tariff filing policy, the Commission's proffer of the above-cap tariff as an alternative to the low end adjustment is a hollow promise that fails to satisfy the constitutional requirements.

In light of the above, in order to satisfy the constitutional requirements of the Fifth Amendment, the Commission should eliminate Section 69.731 or, at the very least, rewrite the rule so as not to apply on holding-company-wide basis.

B. Eliminating the Low-End Adjustment on a Company-Wide Basis Is Not Necessary To Prevent Anti-Competitive Behavior

Implicit in the Commission's reasoning for eliminating the low-end adjustment mechanism on a company-wide basis is the fear that the companies will somehow use the mechanism to gain an unfair competitive advantage. Although the FCC does not explicitly explain its theory, GTE presumes that the Commission is concerned that the carrier would set prices low in those areas where it enjoys price flexibility and to fund those decreases by increasing the rates in their regulated markets. The hypothetical manner through which the carrier would increase those rates would be through the use of the low-end adjustment mechanism.

However, price-cap LECs would not be able to cross-subsidize in the above-described manner. The Commission's own rules prevent such subsidization because the majority of cost and earnings figures are generally measured separately by study area. For example, Section 65.702 requires carriers to measure earnings "separately for each study area," unless it has filed tariffs that aggregate costs and rates for more than one study area.[23] Several sections of Part 36 define how specific costs are to be

---

[23] 47 C.F.R. § 65.702(b).

handled. For instance, Section 36.121 states that "[r]ecords of the cost of central office equipment are usually maintained for each study area separately by accounts."[24] Given the presence of these requirements to segregate these figures, there is little, if any, opportunity for a carrier to shift costs between study areas to permit it to engage in predatory pricing or to trigger the low-end adjustment mechanism. The Commission has already accounted for, and taken care of, that possibility.

Further, the ability of a carrier to engage in cross-subsidization using the regulated markets to offset losses generated by aggressive pricing in unregulated markets is limited by the price cap rules themselves. As the Commission knows, the ability of a carrier to raise prices in regulated markets is constrained by an elaborate set of rules designed to keep prices low. In addition, the continual revision of the productivity factor further restricts a carrier's ability to shift costs by eliminating any additional play a price regulated carrier might be able to take advantage of to cross-subsidize another market.[25] Thus, another major check on any potential cross-subsidization between regulated markets and markets with pricing flexibility are the rules that continue to cap the prices in regulated markets.

In addition, the Commission fails to explain what incentives a carrier would have to exploit the low-end adjustment mechanism to facilitate predatory pricing. In order to trigger the mechanism, a carrier would need to show that it was earning less than the

---

[24] 47 C.F.R. § 36.121(b).

[25] Although GTE believes that continued revisions to the productivity factor are unwarranted, the FCC cannot claim that the low-end adjustment mechanism can produce cross-subsidies when it has already created an environment that makes such cross-subsidies highly unlikely.

low-end adjustment figure. Yet, the low-end adjustment mechanism does not provide rates of return that are particularly attractive to the company or investors. The Commission purposefully set this figure particularly low in order to preserve the "proper incentives" for carriers.[26] Instead of guaranteeing a rate of return that carriers would shoot for, "the lower end adjustment embodies a substantial penalty for LECs" and "represents a substantial drop in profits for a LEC."[27] Given these facts, it is difficult to understand why a carrier would behave in such a manner in order to earn, what the Commission has defined as, an unattractive rate of return.

In fact, the Commission has already permitted price-cap LECs to engage in some limited pricing flexibility without requiring these LECs to surrender their ability to use the low-end adjustment mechanism. In the *Special Access Expanded Interconnection Order*, the Commission amended its "rules to expand the LECs' flexibility in responding to competition" by allowing them to "establish a number of density pricing zones within each study area" for special access rates.[28] This approach was expanded to other trunking services in the *Switched Transport Expanded Interconnection Order*.[29] Yet, in neither case, did the Commission consider eliminating

---

26 *LEC Price Cap Order*, at 6804.

27 *Id.*

28 *Expanded Interconnection with Local Telephone Company Facilities; Amendment of the Part 69 Allocation of General Support Facility Costs*, 7 FCC Rcd 7369, 7454-55 (1992) ("*Special Access Expanded Interconnection Order*").

29 *Expanded Interconnection with Local Telephone Company Facilities; Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, 8 FCC Rcd 7374, 7426-27 (1993) ("*Switched Transport Expanded Interconnection Order*") (expanding zone pricing for entrance facilities, direct-trunked and tandem-switched transport, and dedicated signaling transport).

the low-end adjustment mechanism for fear that this mechanism would somehow support anti-competitive behavior of the price-cap LECs.

Finally, the Commission itself concludes that, once a carrier has qualified for pricing flexibility, predatory pricing would not be likely to succeed. By rule, in order to achieve price flexibility, the price-cap LEC "must demonstrate that competitors have made irreversible, sunk investments in the facilities needed to provide the services at issue."[30] The Commission has concluded that once "irreversible investments" have been made by a competitor, there is no need to protect them from "exclusionary pricing behavior by incumbent LECs, because efforts to exclude competitors are unlikely to succeed."[31] Once equipment has been installed, the sunk costs anchor a competitor to the market and, if one company exits the market, another company can purchase the assets and preserve the competitive market.[32] Additionally, the likely competitors to the price-cap LECs—AT&T, MCI WorldCom—have deep pockets and could withstand a pricing assault, further reducing the likelihood that predatory pricing would succeed in driving competition out of the market.[33] Thus, predatory pricing, the feared evil from cross-subsidization is irrational in this context and, hence, is unlikely to occur.

In light of the above discussion, therefore, the elimination of the low-end adjustment mechanism will not advance the obvious public-interest goal of the Commission. However, given the constitutional import of the low-end adjustment

---

30 *Fifth Report and Order*, at ¶ 24.

31 *Id.* at ¶ 77.

32 *Id.* at ¶ 80.

33 The depth of the resources of these two companies is demonstrated by the tens of billions of dollars they are spending to acquire other companies.

mechanism, the benefits clearly outweigh any disadvantages in keeping the low-end adjustment mechanism. The only conclusion the Commission can reach is to retain the low-end adjustment mechanism.

III. THE COMMISSION MUST REVISE SECTION 69.123 TO CONFORM TO THE ORDER'S ELIMINATION OF THE COMPETITIVE PREREQUISITES TO DEAVERAGING

The Commission needs to revise Section 69.123(d)[34] to be consistent with the Commission's policy in the *Fifth Report and Order.* In the *Fifth Report and Order*, the Commission expressly found that granting price-cap LECs "more flexibility to deaverage these rates enhances the efficiency of the market for those services by allowing prices to be tailored more easily and accurately to reflect costs."[35] To that end, the Commission amended its "rules to eliminate all competitive prerequisites for the deaveraging of trunking basket service rates."[36] Yet, it failed to eliminate the requirement in Section 69.123(d) that at least one interconnector take a cross-connect before the carrier can deaverage rates for "subelements of direct-trunked transport, tandem-switched transport, entrance facilities, and dedicated signalling transport" in a study area.[37] The Commission must act to revise this rule to be consistent with the policy announced in the order.

---

34 47 C.F.R. § 69.123(d).

35 *Fifth Report and Order*, at ¶ 59.

36 *Id.*, at ¶ 62.

37 47 C.F.R. § 69.123(d).

VI. CONCLUSION

The Commission's decision to eliminate the low-end adjustment mechanism for carriers exercising pricing flexibility in just one qualified market is unlawful and unreasonable. First, the elimination of the low-end adjustment mechanism as an option for price-cap LECs fails to preserve the Fifth Amendment requirements imposed upon any rate regulation scheme not to be confisicatory. Second, this policy is unnecessary to avoid the harm the Commission presumably is seeking to avoid and, as such, is unreasonable. For these reasons, GTE respectfully asks the Commission to reconsider its decision and adopt a policy that continues to protect the earnings of carriers by preserving the low-end adjustment mechanism. GTE also asks that the Commission revise Section 69.123(d) to be consistent with the policy announced in the order to remove all competitive prerequisites for deaveraging.

Respectfully submitted,

GTE SERVICE CORPORATION, and its listed affiliates

By: /s/ Gregory J. Vogt

Gregory J. Vogt
Daniel J. Smith
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006-2304
(202) 719-7000
(202) 719-7049 (fax)

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036
(202) 463-5214

Thomas R. Parker
GTE Service Corporation
600 Hidden Ridge, MS HQ-E03J43
P.O. Box 152092
Irving, Texas 75015-2092
(972) 718-6361

Its Attorneys

October 22, 1999